

December 16, 2002

To: Supervisor Yvonne Brathwaite Burke, Chair  
Supervisor Gloria Molina  
Supervisor Zev Yaroslavsky  
Supervisor Don Knabe  
Supervisor Michael D. Antonovich

From: David E. Janssen  
Chief Administrative Officer

**State Budget Update**

***Legislative Analyst Releases Analysis of the Governor's Mid-Year Budget Plan***

The Legislative Analyst's Office (LAO) today released "Analysis of Mid-Year Budget Proposal", its assessment of the Governor's recently released plan to partially address the State's budget shortfall through \$10.2 billion in budget reductions and adjustments. (A copy is attached.) In addition, the LAO Director, Elizabeth Hill, testified on the report before the Assembly Budget Committee this morning. In addition to providing a general assessment of the Governor's proposals, the LAO report looks at specific program areas and highlights proposals that may be problematic or deserving of careful consideration by the Legislature.

***The Overview***

The LAO characterizes the Governor's proposal as "an important first step toward addressing the enormous fiscal problem facing California." Unlike last year's mid-year "corrections", which relied primarily on reversions and funding redirections, this year's proposal involves real and permanent reductions in a wide variety of programs. About two-thirds of the proposal involve spending reductions and approximately 60 percent are ongoing.

According to the LAO, the impact of the \$10.2 billion savings by budget area is:

Education	\$3.40 billion
General Government/Local Government	\$2.60 billion
Resources/Transportation/Housing	\$2.10 billion
Health and Social Services	\$2.00 billion
Criminal Justice	\$0.04 billion

In assessing the overall plan, the LAO concluded “that most of the proposals are credible...”, and that, with the exception of the criminal justice area, the savings were distributed across a wide range of programs. Moreover, while most of the savings seemed achievable, some, such as the deferral of the teacher retirement supplemental payment and the shift of local redevelopment monies to the general fund, might incur legal obstacles. In the LAO’s judgement, the \$1.1 billion across the board reduction in Proposition 98 funding, while within the bounds of the constitutional guarantee, was likely to have undesirable classroom impacts that could be avoided through a more targeted approach. Finally, the LAO noted the lack of balance in the proposal in that it involved no tax increases and few fee increases.

### *Program Areas*

The LAO’s analysis of the Governor’s proposal by program areas contains observations of interest to the County described below.

**Health:** most of the \$1.5 billion savings are from program reductions, especially in Medi-Cal. The 10 percent reduction in Medi-Cal provider rates appears to be targeted such that it will only minimally impact the County, primarily affecting nursing homes and physicians instead. In an effort to draw down additional Federal Medicaid funds, the Administration is proposing a new assessment on intermediate care facilities for the developmentally disabled (ICF/DDs) that would be used for match - a proposal that the LAO suggests could be expanded to include other types of long-term care facilities.

**Social Services:** most of the \$514 million savings come from deleting the COLA for SSI/SSP (\$328 million) and CalWORKs (\$80 million). There is a further savings of \$155 million which must remain in the TANF program, because of the maintenance of effort requirement, which could be used to cover other CalWORKs costs. Alternatively, the LAO points out, the Legislature could retain the CalWORKs COLA by making other reductions in the program. Finally, the Governor has proposed the elimination of naturalization assistance which will provide \$360,000 to the Department of Community and Senior Services this year.

**Judiciary and Criminal Justice:** Most of the \$334 million in savings are in the judiciary with criminal justice cuts limited to \$39 million in the current year. According to the LAO, the budget year reductions in the courts will have significant programmatic and staffing impacts.

**Local Government:** Two proposals account for most of the over \$1.5 billion in savings that would come at the expense of local governments. The Governor has proposed shifting the unencumbered balances in local government redevelopment agencies low - and moderate - income housing accounts to the general fund for an estimated savings of \$500 million. In addition, he again proposes to defer payment of virtually all non-education mandates for a savings of \$769 million. The LAO notes that the redevelopment fund shift may have legal and constitutional problems but is nevertheless a reasonable "starting point" for discussing revenue transfers by redevelopment agencies. As for the deferral of mandate payments, the LAO estimates it to be worth \$1.2 billion and suggests that the Legislature take a serious look at suspending or repealing certain mandates.

In addition to providing an analysis of the Governor's proposal, the LAO has provided two pages of additional budget-balancing options, as well as some suggested revenue options, for the Legislature to consider. Included in the latter are rate changes, such as restoration of the VLF to its 1998 level, temporary imposition of high-income tax brackets as done in the early 1990's budget crisis, an income tax surcharge and a half cent sales tax increase; base broadening by extending the sales tax to items currently untaxed such as amusement or recreation services; and changes in tax expenditures to suspend or eliminate such things as the teacher tax credit or the research and development credit.

The LAO concludes with a section entitled "Additional Comments and Considerations" that are much more than after thoughts. Receiving special emphasis is the need for prompt action because each month of delay reduces the savings otherwise available, not only in the current year but also in the budget year for many items that require lead time to implement. The savings estimates in the Governor's proposal assume adoption by the Legislature during January. Similarly, if the Legislature wishes to restore the VLF rate, it will take at least three months to implement and each month of delay would cost roughly \$300 million. Finally, if the Legislature decides to raise taxes, Proposition 98 and education would receive over 50 cents of every dollar of the first \$5 billion raised, making the task of balancing the budget even more difficult. This would not be true for the VLF restoration, which is a budget reduction rather than a tax increase. In addition, the Legislature could suspend the Proposition 98 guarantee for a special tax, as they did with the realignment sales tax increase in the early 1990's. Finally, the LAO suggests a few ways the State could increase local property taxes - through changes in business assessment practices or the elimination of exemptions - that would reduce State funding for schools.

### ***Assembly Budget Committee Hearing***

The Assembly Budget Committee met this morning to hear presentations on the Governor's proposal from Robert Miyashiro, Deputy Director of Finance, and Elizabeth Hill, Director of the LAO. In addition to discussing the proposal, Mr. Miyashiro indicated that a new estimate of the shortfall had been prepared and would probably be released later this week. Miss Hill emphasized the need for careful consideration of the proposals, given that most were

Each Supervisor  
December 16, 2002  
Page 4

ongoing reductions, but also stressed the need for prompt action to achieve the savings. Finally, Chairperson Oropeza (D-Long Beach) stated that the committee would take a balanced approach to addressing the budget shortfall by including revenue increases as well as budget savings. Toward that end she announced the creation of an informal working group of members, which she hoped would be bipartisan in makeup, headed by John Dutra (D-Fremont), to look at revenue options.

***Speaker Announces Membership of the Assembly's Commission on Structural Challenges to Budgeting***

The Speaker recently announced his appointments to the special commission that was agreed to as part of last year's budget compromise. The commission is required to finish its work by May 2003. The members include: Assembly Speaker Herb Wesson, Chair; Assembly Republican Leader Dave Cox, Vice Chair; Assemblymember Patricia Bates; Assemblymember John Campbell; Assemblymember Joe Canciamilla; Assemblymember John Dutra; Assemblymember Jenny Oropeza; Assemblymember Jackie Goldberg; Assemblymember Rick Keene (alternate); Assemblymember Bill Maze; Assemblymember Joe Nation (alternate); Assemblymember Sharon Runner; Assemblymember Darrell Steinberg; and Assemblymember Tony Strickland.

***Reminder: The Health and Human Services Subcommittee of the Assembly Budget Committee is meeting Tuesday, December 17, 2002, at 1:00 p.m. in the Department of Insurance Hearing Room on the ground floor of the Reagan Building, 300 South Spring Street on the impact of the Governor's proposed budget reductions.***

We will continue to keep you advised.

DEJ:GK  
MAL:JR:ib

**Attachment**

c:     Executive Officer, Board of Supervisors  
       County Counsel  
       Local 660  
       All Department Heads  
       Legislative Strategist  
       Coalition of County Unions  
       California Contract Cities Association  
       Independent Cities Association  
       League of California Cities  
       City Managers Associations  
       Buddy Program Participants